

III. THE SETTLEMENT PROCESS

A. Policy and practical considerations

1. Settlement versus litigation: in general

The most fundamental tenet of Tax Division settlement policy is that we will concede a position that is erroneous, but compromise is justified only by litigation hazards and collectibility concerns.

The courts are the apex of the controversy resolution structure within the Internal Revenue Service, which is very much geared to settlement if at all possible. Thus, settlement is a primary function of the Appeals Offices, and Appeals settles close to 90% of the cases it considers.

The Tax Division does not settle cases based on nuisance value. For it to do so would undercut totally the efficacy of the settlement structure within the Internal Revenue Service. On the other hand, the Division endeavors to litigate when it is appropriate, to concede when it is appropriate, and also to compromise (when it is appropriate) on terms which are just and in the Government's best interests.

From the outset of a case, the question of litigation or settlement should be considered. Bear in mind that the easiest (but not necessarily the most advantageous) course of action is to settle the strongest cases and litigate the weak cases. It is the easiest course of action because taxpayers' counsel will want to settle their weak cases. Unfortunately, settlement of a case where the Government is strong and litigation where it is weak may not contribute to the orderly and rational development of the tax law. Moreover, it is undoubtedly true that hard cases make bad law. Accordingly, both in evaluating the litigation and settlement posture, equities (as well as precedent) must be taken into account, and, if the case is to be litigated, all equities should be developed carefully to show that the Government's position is reasonable.

In weighing litigation versus settlement, it is vital to take into account the case as a whole. Assume, for example, that a case raises a multitude of issues so that, were taxpayer to prevail on all, its tax liability would be reduced by a million dollars, but because of § 6511(b)(2) limitations its ultimate recovery is restricted to \$100,000. If the taxpayer agrees that its ultimate recovery is limited to \$100,000, settlement may well be appropriate at or approaching that figure. If the taxpayer does not agree that § 6511(b)(2) restricts its recovery, then

summary judgment is appropriate to resolve the jurisdictional issue.

The weighing of litigation versus settlement should be a continuing process, as the Trial Attorney's knowledge increases and there are new developments which should be taken into account. In this connection, the Trial Attorney should also consider as the litigation progresses whether the alternative dispute resolution ("ADR") procedures addressed in Part VI are appropriate in a particular case.

2. The need for preparation

The basic principles applicable to litigation are equally applicable to settlement. Good preparation is the key to both. Indeed, the surest way to obtain a good settlement is to do a good job of preparing the case for trial. Considering the work load of the revenue agents, there is virtually no way that an audit could produce all the admissible evidence necessary for a successful trial of a factual issue, such as valuation.

3. The need for communication with the IRS

In settlement, as in litigation, it is very important to communicate with the Internal Revenue Service--and this includes not only the attorneys at the Service who prepare defense letters, requests to bring suit, and recommendations re settlement, but also the people who actually worked the cases (or related cases) such as revenue agents, special agents, engineering agents, international examiners, and Special Procedures and Service Center personnel. Often, by talking with these people, the Trial Attorney can obtain information which is not in the files. Moreover, talking with Service personnel is particularly important in cases involving continuing issues--issues which arise not only in the year in suit, but also in subsequent years. Such cases are more difficult (although not impossible) to settle.

Always talk with someone at the Service whose position you disagree with, or do not understand, before launching an offensive in writing. Disagreements re settlements can provoke hard feelings which impede working together harmoniously in the future, and one must negotiate heartfelt cooperation just as one must negotiate a settlement offer.

4. Concessions -- the Trial Attorney's role

If it is believed that the Government's case lacks any merit whatsoever, the case should be conceded. Normally, the Service

will recommend concession in such a case in its defense letter; however, in cases where it has not done so, the Trial Attorney may subsequently develop facts or law that justify concession. If the Trial Attorney believes that the Government's position is erroneous, the attorney should consult with a supervisor and possibly direct a letter to the Internal Revenue Service requesting it to reconsider the matter. The same procedure should be followed if the Service recommends concession but the Trial Attorney believes that defense is merited. In this connection, bear in mind that it is very dangerous and unproductive to litigate a legal issue contrary to the views of the Internal Revenue Service; the Service can resolve the matter by issuing a revenue ruling which will effectively require concession of the case. If a Trial Attorney litigates and wins an issue over the opposition of the Internal Revenue Service, there is a very great likelihood that the Government will confess error. Accordingly, if the Trial Attorney disagrees with the Service's recommendation for concession, it is necessary to convince the Service that important facts or legal arguments or other considerations were not previously called to their attention, and that defense is appropriate.

B. Initial matters to be considered regardless of the
likelihood of settlement

1. Collection cases and counterclaims

In any case involving a counterclaim, just as in any collection matter, collectibility is likely to be a prime consideration. Even though the case may be a strong one for the Government on the merits, one does not want to expend substantial resources to obtain an uncollectible judgment. Accordingly, preliminary steps should always be taken whenever a collection suit or counterclaim is filed. These include:

(a) Contact Special Procedures and actually talk with the people involved to find out what they have done in the past, what they are doing now, and what they believe the collection potential to be. Almost certainly, one will want to be assured that notices of federal tax liens have been filed or refiled in each appropriate location.

(b) As a rough indication of what the taxpayer's financial position may be, ask the Service (or, if necessary, the taxpayer) for copies of income tax returns, beginning with the period in litigation and going up to the present, or some shorter period. If tax returns are not available, ask the Service for transcripts of account for the same period. Matters to consider are not only assets held at the time of litigation, but sources of income

which were reflected on earlier returns but disappear on later returns, indicating possible transfers without consideration. And, in this connection, follow up and obtain copies of the income tax returns filed annually, as the suit progresses.

To the extent that it becomes apparent that collectibility will be a major problem, and that the potential for substantial collection is slight, it is more efficient to negotiate a collectibility settlement than to do a lot of work to obtain a judgment which proves uncollectible.

2. Refund cases

In refund cases, questions which frequently come up in the context of settlement involve offsets, duplicate allowances in other years or with respect to other taxpayers, and equitable recoupment. These are issues which, ideally, should be addressed, and recognized, at the time that the defense letter and administrative files are received.

a. Offsets

It may be that the defense letter suggests offsets which should be asserted. One's own analysis of the administrative files may uncover additional offset issues. For example, nonbinding settlements may have been made administratively as to which the taxpayer has now reneged. That is, the revenue agent may have proposed adjustments which were ultimately not made, in a situation where no Form 870-AD (or other Appeals Office agreement) was executed. In this situation, the adjustments previously given up by the Government (if meritorious) should now be asserted.

Additionally, the Trial Attorney should normally talk with the revenue agent about the case; everything that the agent knows may not have been put in writing. For example, there may have been issues raised in subsequent years which (but for limitations) could and would have been raised for the suit years; these, also, could be made the subject of offsets. Bear in mind, however, that it is inappropriate to embark on a general fishing expedition in search of offsets. Most generally, offsets are an adjustment correlative to the taxpayer's prevailing on its claim, or issues ascertained on looking at the return and administrative files, or based on conversations with people at the Service familiar with the case. Offsets are discussed in greater detail in Part IV, Chapter A.

b. Double allowances in other years or
with respect to other taxpayers

To the extent that a case involves the proper year for allowance of a deduction or inclusion of an amount in income, the Trial Attorney must be aware that resolution of the litigation will likely have consequences in another year. This is relevant in determining how much money is really involved in the litigation, which affects the prospects for settlement.

Similarly, cases may involve questions affecting related taxpayers--for example, whether income is taxable to a trust or its beneficiaries.

In such cases, an important consideration that must be borne in mind in considering settlement is the ambit of the mitigation of limitations provisions, §§ 1311-1314 of the Internal Revenue Code, discussed at Part IV, Chapter B. To fail to do so may result in double allowances in the suit year and the non-suit year, or a double exclusion of the same amounts from income of the trust and its beneficiaries.

c. Equitable recoupment

In our defensive litigation, equitable recoupment technically involves a situation where the taxpayer is suing for a refund with respect to one kind of tax, and, if the taxpayer were to prevail, there would be an adjustment favorable to the Government with respect to another kind of tax, but the period of limitations has expired with respect to asserting a deficiency. Particularly in the estate tax/income tax area, discussed infra at 50-55, the Trial Attorney should be alert to the possibility of pleading equitable recoupment as an affirmative defense.

Importantly, where an adjustment favorable to the taxpayer in the refund suit should (barring limitations) produce a corresponding adjustment in the Government's favor, the very best defense of all is to ascertain, as early as possible and, ideally, no later than when the answer is filed, whether the period of limitations has expired with respect to the correlative adjustment as to another tax or another taxpayer. The earlier such questions can be resolved, the more likely it is that the period of limitations will still be open (whether for assessment, or because there is another claim for refund pending by the taxpayer which could be offset by a correlative adjustment).

Equitable recoupment is discussed in greater detail in Part IV, Chapter C.

3. Employment tax cases

In cases involving the question whether workers are employees or independent contractors, there are several considerations to take into account.

1. The first issue to be considered in all these cases is the applicability of § 530 of the Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2885 (reprinted at 26 U.S.C. § 3401 note). This relief provision was enacted by the 1978 Act as a temporary measure, and subsequently made permanent even though not part of the Internal Revenue Code.

Section 530 was the result of what the industry lobbyists and the Congress viewed as overaggressive audit and assessment activity by the Service. To litigate and lose employment tax cases can only serve to perpetuate the stereotype. Accordingly, these cases are among the most important cases that a Tax Division attorney will be handling, and it is very important to evaluate accurately the litigation hazards, as well as the settlement potential.

If § 530 provides relief (and Congress, in enacting this provision, intended to provide relief where the taxpayer had "any reasonable basis" (liberally construed) to treat workers as nonemployees), one will never get to litigate the employee-independent contractor issue.

2. In determining the amount involved, check to determine whether the Service has correctly applied § 3509. There have been instances where it has failed to do so, resulting in the necessity for partial concession.

3. If employee-independent contractor is a continuing issue, it is difficult to settle without obtaining future compliance. However, such compliance is a very valuable concession which the taxpayer can make without present out-of-pocket cost. In a future compliance settlement, it is important for the owners of the business to agree that, even if the form of business changes, the workers will still be treated as employees in the future.

C. Negotiation

1. Basic principles

Effective negotiation is a skill, just like effective cross-examination or any other litigation skill. Effective negotiation also requires preparation--one must think about and prepare for

informal settlement discussions or a formal settlement conference just as one prepares for a hearing. Effective negotiation also requires that one must listen to what one's opponent has to say, and imagine oneself in that opponent's place.

Negotiation is not confined to a settlement context. It is involved in negotiating a stipulation of fact, in preparing a joint submission to the court, and in many other aspects of litigation and life.

Accordingly, the possibility of negotiating a settlement, and what the Trial Attorney would want with respect to settlement (or whether any settlement would be desirable or feasible), is something which should be borne in mind from the time the suit authorization letter or the defense letter is received. Of course, as the case is developed factually and legally, perception of the feasibility or appropriate basis for settlement will change, as perception of litigation hazard and the best course of action for prosecuting or defending the case will change. Similarly, the Trial Attorney should consider and revisit the question of the value of using ADR procedures and which ADR procedures may be most appropriate in a particular case throughout the litigation process.

A Trial Attorney does not have settlement authority, and this must be made very clear to opposing counsel during settlement discussions or conferences. Consequently, it is a good idea for a Trial Attorney to discuss settlement potential and problems with the Section Chief before the negotiations are commenced. Bear in mind, however, that these discussions may not cover all aspects of the facts and law, and that a Section Chief may later raise questions or objections which were not perceived until the settlement memorandum was submitted.

It is advisable, particularly in complex cases, to write a memorandum to the file (however brief and informal) concerning settlement negotiations. This will assist in refreshing the Trial Attorney's recollection concerning the course of the negotiations. Moreover, when a case is reassigned (as, for example, on the departure of an attorney), it is exceedingly useful to have a record of what settlement discussions were held, and what they were.

In every refund suit, the taxpayer wants the money as soon as possible, and may request or require a commitment as to the time necessary to process the settlement. Of course, the Trial Attorney should endeavor to write up a negotiated settlement promptly (it takes much less time to write up a settlement if it is done sooner rather than later). However, the Trial Attorney

must be careful not to promise more than he or she can do. Moreover, it is essential that the Trial Attorney check with the Service, the Trial Section Chief, and (in a case which requires reference to that Office) the Chief of the Office of Review, before making any commitments as to the time necessary for processing a settlement.

2. Formal settlement discussions

With local rules pushing early settlement conference and the 1993 amendments to the Federal Rules of Civil Procedure (in particular, Rule 16 and Rule 26) requiring the exchange of "core information" and accelerating the time for pretrial conferences, settlement discussions frequently occur early in our cases.

Pursuant to Executive Order 12778 on Civil Justice Reform, and the policy of the Tax Division, as soon as adequate information is available to permit an accurate evaluation of the litigating hazards, the Trial Attorney should offer to discuss settlement with the opposing side. And, in courts where we know settlement conferences occur quickly, the Trial Attorney should make every effort to be ready for meaningful settlement discussions.

There is an obvious tension here. While early settlement discussions are encouraged to avoid unnecessary and costly discovery for both sides, the Trial Attorney can participate meaningfully in settlement discussions only after he or she has undertaken sufficient research and discovery so that the strength of the Government's case can be determined. If trial counsel does not have the necessary information to evaluate the case, settlement discussions will be premature and unproductive.

When settlement discussions get down to concrete figures and other terms, typically opposing counsel suggests a basis for settlement, and the Trial Attorney will respond, advising whether he or she will recommend the settlement proposed, or suggesting some other basis for settlement. The very term "negotiation" suggests some give and take. However, there will be instances where the Trial Attorney (or Assistant Chief or Section Chief) will say that he or she will recommend a settlement of x amount and will not budge one dollar from that figure.

The formulae for possible settlement cover as broad a range as tax matters generally, and the appropriate formula will depend on the case, and the needs of the parties.

Compromise of a § 6672 case based on litigation hazards will obviously depend on the litigation hazards for each quarter. If

there is more than one responsible person involved, it is clearly preferable to settle as to all--unfortunately, this is not always possible. As an addendum, in negotiating settlement of these cases, it is always well to bear in mind that substantial interest may have accrued, even though the principal amount of the § 6672 liability remaining is relatively small.

In any multi-issue settlement of tax issues (other than the very small, factual case), it is generally advisable to begin with putting each issue on the table, and knowing how much is involved as to each. A good starting point is the notice of deficiency, or the RAR statement of audit changes. Generally, in an issue settlement, either issues are traded, or one party concedes one or more issues and other issues are settled on a percentage basis. Bear in mind that if there are two issues in a case, and one issue involves \$5,000 and the second \$100,000, it is not considered as a 50-50 settlement if it is proposed that the taxpayer concede the first issue and the Government the second. Neither is it regarded as a 50-50 settlement where on the first issue (which the taxpayer offers to concede) the Government is supported by the Tax Court and three courts of appeals, while on the second issue which it is proposed the Government concede there is no case directly in point and two conflicting lines of authority.

A settlement may be based on an offer to accept a refund of a flat amount, plus interest. Thus, in a suit for refund involving possibly \$5,000, an offer may be submitted to accept a refund of \$2,000, plus interest. These settlements are particularly appropriate to the relatively small case involving several issues where the effort and delay in preparing a computation may not be justified. However, this type of settlement is appropriate only if both parties have a pretty good idea of the amount involved, or the amount involved on each issue. Otherwise a recomputation may well be necessary in order to evaluate the concessions being made in a settlement calling for a refund of a flat amount.

In any case where the settlement is based on collectibility, it is imperative to have the necessary financial information before the Trial Attorney can, in any sense, "negotiate." In such cases, the most feasible course of action is to invite the taxpayer to submit the necessary information and to make the best offer possible. The information submitted can then be verified by the Service to the extent appropriate. Typically, such information would consist of (1) a completed Statement of

Financial Condition & Other Information (DJ-TD 433 (1996) (Ex. C) 5/ and (2) copies of income tax returns for the prior five years. See Part V, infra, where collectibility settlements are discussed in depth.

The simplest settlement to structure is one where the Service has made a deficiency assessment (based solely on the issue in litigation) and the refund suit only involves this assessment and no other years or parties are involved. Bear in mind, however, that a percentage compromise of a deficiency assessment is to be avoided where the assessment comprehended more than one issue, but only one is being litigated.

Where the disputed liability is substantial or the taxpayer is in a trade or business, a settlement based on income adjustments is the norm. Inter alia, an issue settlement obviates problems which might arise in determining the consequences of loss or credit carrybacks to or through the years in litigation.

An issue settlement is always necessary if the issue(s) in suit have consequences in or occur in subsequent years, or affect other taxes or other taxpayers. For example, if the issue is capital expenditure or ordinary expense, have capital loss carrybacks or carryovers been allowed? Have depreciation deductions been allowed in subsequent years? Are deductions being allowed by settlement which increase alternative minimum tax liability? What are the consequences of allowance of investment tax credits? Are there interrelationships between estate tax and income tax liability? In these situations, the Trial Attorney must be alert to ascertain whether the affected years or liabilities of other taxpayers are open. If it is crystal clear that the affected years or related liabilities are open, make their adjustment part of the settlement. And, if closed, endeavor to make appropriate adjustment part of the settlement, bearing in mind that the affected year can be reopened by mitigation of limitations, if a qualifying "determination" is obtained, or equitable recoupment may be applicable. See Part IV, Chapter B, re Double Allowances--Mitigation of Limitations (§§ 1311-1314), at pp. 47-49, infra, and Part IV, Chapter C, re Equitable Recoupment, at pp. 50-55, infra.

In short, an offer should cover all collateral issues. These include, in addition to those just discussed, the

5/ IRS Forms 433-A and 433-B are not satisfactory for our purposes.

permissibility of crediting any overpayment against any other liability of the taxpayer pursuant to § 6402, waiver of attorney fees, and interest. A carefully crafted settlement can save an attorney a tremendous amount of unnecessary work and the Government a lot of money.

3. Settlement conferences with the court

As court dockets become overloaded and courts adopt rules to accelerate settlement conferences, the burden becomes heavier on each party's attorney to be prepared for an early settlement conference. If a court orders a settlement conference before the parties have completed essential discovery, the Trial Attorney should attempt to postpone the conference, preferably with the assistance of opposing counsel. If the parties have utilized the alternative dispute resolution procedures (ADR) described in Part VI, but have been unable to settle the case, it may be appropriate to notify the court of that fact and ask that the parties be excused from participating in a mandatory settlement conference.

Generally, an order requiring a settlement conference will direct the Trial Attorney of record to attend. Before attending the conference, the Trial Attorney should discuss settlement prospects with his or her Section Chief. The Section Chief will normally provide the Trial Attorney with guidelines for an acceptable settlement.

It is essential that Tax Division trial attorneys know who has settlement authority in a particular case and develop skills to participate effectively in court-ordered settlement conferences. By the time of a conference, if not earlier, the Trial Attorney should be able to espouse the strengths of the Government's position and be able to approach settlement discussions with an open and reasonable view. Although settlement conferences may, on occasion, generate considerable pressure on the Trial Attorney to recommend a proposal under discussion, it is shortsighted to agree to recommend unacceptable settlement terms. The ultimate rejection of the Trial Attorney's recommendation and of the offer can cause extreme tension between the Government and both the court and the opposing side; it can create the impression that the Department official having settlement authority rejected the offer without full knowledge of the case.

Court orders (and local rules) vary concerning settlement conferences. When first receiving notice of a conference the Trial Attorney should ascertain who is required to attend since sometimes the orders require that the person with full settlement

authority attend. Depending on such factors as the amount in suit and whether the Internal Revenue Service designates the case as "Standard" or "SOP," this type of order often means that the Section Chief or the Assistant Attorney General is ordered to attend and it could possibly require the attendance of the Associate Attorney General. When facing this type of court order, the Trial Attorney should immediately consult with the Section Chief. Normally, the Trial Attorney will be advised to contact the local United States Attorney to determine whether the Department has been excused from similar orders in other cases, and for any advice concerning an appropriate course of action. If it seems appropriate, the Trial Attorney should contact the court's clerk and attempt to find an informal way to be excused from the requirement. In some situations, the Section Chief may believe it will be helpful for the Chief or some other supervisor to be available by phone during the conference and this alternative may be offered to the court as a compromise.

If informal efforts fail, under most circumstances, the Section Chief would authorize the filing of a motion with the trial court, asking to be excused from the local rule or court order and, in the alternative, seeking a stay of the conference pending consideration by the Division and the Solicitor General whether a petition for mandamus will be filed. If this is denied, the Tax Division may seek an emergency stay with a court of appeals and, if granted, file a petition for writ of mandamus on the ground that the Department would be unable to function effectively if key officials could be ordered to appear at court-ordered settlement conferences.

Most courts recognize that the Associate Attorney General should not be required to attend settlement conferences. Because there are usually 22,000 pending cases in the Tax Division, it would also be physically impossible for the Assistant Attorney General to attend settlement conferences on a regular basis, or even to participate by phone. Indeed, if a Section Chief were required to attend all settlement conferences in person, that could consume all or the greater portion of the Chief's time and make it impossible for the Chief to perform the other functions of the position.

The Department has sound legal arguments for contending that a court lacks the inherent power to issue an order requiring the attendance at a settlement conference of the person with full settlement authority. Under the doctrine of separation of powers as expressed in 28 U.S.C. §§ 517 and 519, the Attorney General has the responsibility of representing the United States in judicial proceedings and directing other offices of the Department in conducting litigation. A court lacks the power to

tell the Attorney General what settlement authority must be conferred on the Trial Attorney designated to handle a particular case. As stated in the legislative history of the Judicial Improvements Act of 1990, Pub. L. No. 101-650, 104 Stat. 5089 (28 U.S.C. § 473), "the Department cannot realistically send officials with full settlement authority to each settlement conference." 6/

In In re Stone, 986 F.2d 898 (1993), the Fifth Circuit held that the district court has the inherent power to order the Executive Branch to send a high-ranking official to a settlement conference, and it vacated the district court's orders and stated that the district court abused its discretion in routinely ordering the Government to send an official with full settlement authority to a conference. The Circuit went on to state, however, that the court could issue such an order in certain extraordinary circumstances. While the end result in Stone was correct, in the Government's view the Fifth Circuit was incorrect in concluding that the district courts have the inherent power to issue such orders. We expect that this issue will be presented to other courts of appeals and that the Supreme Court may have to resolve it.

4. Partial settlements

To narrow the issues for trial, the parties may wish to enter into a partial settlement. Generally, a Trial Attorney should attempt to negotiate a compromise which disposes of a case completely, where possible, and avoid piecemeal settlements. Relationships between the issues settled and those reserved for litigation may not become apparent until (too late) when the latter are addressed. Moreover, settlement of the case as a whole obviates a need for multiple computations, the preparation of more than one compromise memorandum, and the review of more than one memorandum by the designated official. It also avoids any appearance that partial settlements were negotiated in an effort to keep review of the settlement at the Section Chief level. Bear in mind, moreover, that the total amount conceded in all prior settlements is taken into account in determining jurisdiction to act on any subsequent settlement.

Nonetheless, there are times when partial settlements are either advisable or necessary. If a case presents 20 issues, it is clearly advisable to attempt to settle as many as are

6/ Civil Trial Section, Western, has had a number of cases on this issue and a Trial Attorney in another section may wish to consult with them.

feasible. To do so both narrows the issue for trial and permits the Government to present its case most forcibly on appeal, where the page limitations on brief and time limitations on argument are exceedingly stringent.

In a partial settlement, there are pros and cons with respect to when computations should be prepared. Thus, inasmuch as previously unconsidered "issues" (or effects of a computation) may surface when a computation is prepared, it is well to have computations prepared sooner rather than later. Indeed, it is sometimes essential to prepare computations in order to determine who has the authority to approve the settlement. On the other hand, there is merit in having any overpayment computed at the end of the case to avoid the need for multiple computations. Moreover, new offsets may be discovered in the course of litigating a reserved issue. Additionally, whether or not an overpayment is scheduled immediately on conclusion of a partial settlement (in which case computations will probably have been prepared) will depend on a number of factors, including the posture of the case, the complexity of the necessary computations, and any possible interrelationship with issues which remain to be litigated.

5. Factors favoring settlement generally, and factors generally rendering settlement difficult or unlikely

Certain cases are more appropriate for settlement than others. However, that there are a number of factors favoring settlement in a particular case does not mean that a case can or should be settled, or that the parties can reach agreement on terms that are fair to both sides. Similarly, that there are factors which weigh against the likelihood of settlement does not mean that a case cannot or should not be settled. Nonetheless, the Trial Attorney may want to consider some of the various factors favoring and disfavoring settlement in weighing the potential for settlement versus litigation.

(a) Factors favoring settlement include the following:

- (i) The case involves largely factual issues and the legal principles are well established (e.g., valuation cases, substantiation cases, trust fund recovery cases).
- (ii) The case is legally and/or factually complex.

- (iii) The case involves multiple independent factual issues (e.g., bankruptcy cases).
- (iv) The case is one where there is a particular need for a prompt resolution of the dispute (e.g., summons, estate tax and bankruptcy cases).
- (v) The case is one where a consensual resolution may lead to greater future compliance (e.g., employee-independent contractor cases).
- (vi) A settlement in the case would be based solely on collectibility.
- (vii) The other party has a particular need to keep information confidential (e.g., financial information or trade secrets).
- (viii) There are problems perceived either with respect to the decision-maker or the forum, for example:
 - (A) The judge is particularly slow in resolving cases;
 - (B) The docket is backlogged with criminal and/or civil cases;
 - (C) There is the potential for jury nullification.
- (ix) The case is one where the Government will be required to litigate in a forum other than a federal court.
- (x) The case is one where the nature or status of a party to the dispute might, in itself, influence the outcome of the litigation (e.g., sympathetic plaintiff).
- (xi) The case is one where there are substantial litigating hazards for both parties.
- (xii) The case is one where trial preparation will be difficult, costly and/or lengthy and the expected out-of-pocket and lost opportunity costs outweigh any benefit the Government can realistically expect to obtain through litigation.

- (xiii) The case is one where it is desirable to avoid adverse precedent.
 - (b) Factors disfavoring settlement include the following:

- (i) Taxpayer's case clearly has no merit (e.g., certain Bivens cases or protestor suits).
- (ii) The case is one that should be resolved on motion, such as a motion to dismiss or for summary judgment.
- (iii) The case presents an issue where legal precedent is needed, for example:
 - (A) Issue involved is of national or industry-wide significance;
 - (B) Issue is presented in a substantial number of cases;
 - (C) Issue is a continuing one with same taxpayer.
- (iv) The importance of the issue involved in the case makes continued litigation necessary despite some adverse precedent.
- (v) The information presently available about the case is insufficient to evaluate meaningfully the issues involved or settlement potential.
- (vi) The case involves significant enforcement issues, for example:
 - (A) Case involves protestors;
 - (B) Case is high profile and will involve publicity which could encourage taxpayer compliance;
 - (C) Case involves a uniform settlement position (e.g., shelter cases).
- (vii) The case involves a constitutional challenge.

6. Attorney fees

A term of every settlement should cover the taxpayer's right to claim attorney fees. Unless there are unusual circumstances, we should require that the offer provide that each party is to bear its own costs, including attorney fees. The obvious reason is that little is accomplished in saving litigating costs if we have to litigate taxpayer's right to attorney fees, especially if the principal issue in the fees dispute is whether the Government's position on the settled issue was substantially justified.

7. Computations

Obtaining computations prior to the time a compromise or concession is approved is most desirable. The results of a computation can, on occasion, be surprising--what you may think is a 50% Government concession may turn out to be a 90% Government concession because of the vagaries of the computation, limitations kicking in, etc.

A relatively easy way to approach this, particularly in cases where the taxpayer is a large corporation or a substantial amount is at issue, is to ask taxpayer's counsel to submit a computation together with the offer. Or, if an unsolicited offer is received, and it is worthy of serious consideration, this request can be made at that time. The taxpayer's computation should then be checked either by the Service or by the Tax Division's recomputation specialist.

Please bear in mind that, while the Trial Attorney may not be responsible for the arithmetic involved in a complex computation, the Trial Attorney is responsible for ensuring that the computation is conceptually sound and eyeballing it to ascertain that it is reasonably correct. This is true, also, of computations prepared by Government personnel, which still require review. For example, there have been instances in which an agent, calculating an overpayment in an estate tax case, has picked up, instead of the figure for the gross estate as determined on audit, the figure for the taxable estate, and then proceeded to deduct a second time the amount allowable in going from the gross estate to the taxable estate. Unless attention is paid to the correctness of the computations, settlements which appear greatly to the Government's best interests, when described in terms of litigation hazards, may prove greatly to the Government's detriment when the check is cut.

Be aware that there can be hidden variance problems which can be injected into a case in the course of a computation

process. It is possible that a well-informed person preparing a recomputation may perceive issues in making the computation (whether pursuant to settlement or judgment) which had not previously been addressed. If the case were litigated, and the Government won, of course the taxpayer could not recover with respect to an issue not raised in the complaint or claim for refund. Similarly, if we lost, the taxpayer could not prevail on an issue which had not been involved in the litigation. Accordingly, recomputations must be scrutinized to be sure that they do not address issues that the taxpayer has not raised in its refund claim or suit.

8. Interest

In any refund suit, it is not a good idea to accede to a request that all of the overpayment be considered tax, and no part interest. Interest received is taxable, and recoveries of assessed interest or deductible taxes are taxable if previously deducted, but recovery of a nondeductible tax is not includible in income. Moreover, despite a provision in a settlement that assessed or statutory interest is to be waived, or to be calculated in a particular way (e.g., at half the statutory rate), the Service Center may allow assessed interest or calculate statutory interest in the usual way.

In a collectibility settlement, it is usual to require that no part of the payment is deductible for federal income tax purposes.

9. Section 6402 of the Code

Pursuant to § 6402 of the Internal Revenue Code, any overpayment due a taxpayer may be credited against any other outstanding tax liability of the taxpayer, and certain other specified liabilities. Every settlement resulting in an overpayment -- whether by compromise or concession -- should provide for the applicability of § 6402.

D. Offer and acknowledgement

The Trial Attorney must always be aware that the taxpayer's offer and the Government's acceptance constitute a contract. Failure of the parties to state their intention can lead to the dispute being presented to the court as in any other contract dispute.

All offers must be in writing, i.e., the taxpayer is required to submit a written offer even if the taxpayer makes an oral offer at a pretrial conference with a judge in attendance.

The offer should contain all the proposed terms of settlement. This avoids disputes as to what the parties intended and the admission of parol evidence. For example, the offer should address the permissibility of crediting any overpayment pursuant to § 6402, attorney fees, interest on either the refund to or payment by the taxpayer, all problems concerning effect on other years, any issues concerning basis, and so on.

The Trial Attorney should send an acknowledgement letter promptly, generally within three days from the receipt of the offer. This letter should clarify any term of the offer that needs revision. If the terms of the offer do not require clarification, an acknowledgement is still required, but no restatement of the terms of the offer is necessary. If the acknowledgement letter is, in effect, stating new terms (even though they are relatively modest provisions), we should require the taxpayer's representative to agree to the revisions in writing. An effective way of obtaining the agreement is to request the taxpayer or the taxpayer's representative to sign and return a copy of the acknowledgement letter.

Trial Attorneys sometimes spend large amounts of time clarifying (after the fact) what a settlement offer really means. For this reason, it is often a good idea to see a draft offer, approve it or suggest revisions, and then have taxpayer make the actual offer. In the right case, the Trial Attorney may even prefer to propose the terms of the draft offer (being careful, of course, not to seem to be making an offer).

If the offer letter contains some terms which are totally unacceptable but the offer is otherwise worthy of consideration, the Trial Attorney should consider restating the terms that may be acceptable, pointing out the unacceptable terms and asking the taxpayer's representative to confirm in writing if he or she wishes to make an offer on the revised terms.

E. Counteroffers

Inasmuch as the Trial Attorney does not have settlement authority, the Attorney must take care not to seem to be making a settlement offer, rather than stating what the Attorney's recommendation would be. In an unusual case, after a settlement memorandum has been prepared, it may be appropriate for the Trial Attorney, while recommending rejection of a pending offer, to recommend the making of a formal counteroffer (i.e., a statement that, if an offer on these terms is submitted, it will be accepted). Such counteroffers, although not routine, may sometimes be utilized in situations where the Section Chief has settlement authority. They are extremely unusual, but not

impossible, when the Office of Review has authority to accept or reject the offer. This discussion assumes, of course, agreement by the Internal Revenue Service to the course proposed (or SOP classification). In all cases the making of formal counteroffers must be approved by the person who would have authority to accept the offer.

F. Concessions and administrative settlement

As the chief litigator of the United States, one of our important functions is to make sure that the Government has a legitimate litigation position in each case that we handle. We must recognize that requiring a taxpayer to litigate his or her rights in court is expensive and stressful. In addition, we must consider the court's time and our need to retain the court's goodwill. And--quite apart from the costs to others and ourselves--it is our obligation to concede cases in which our position lacks merit.

If the Trial Attorney believes that the Government should concede an issue or the entire case, he or she must obtain the recommendation of the Service, even in cases that have been designated SOP. (There is one exception to this rule, namely, in a responsible person case (§ 6672 of the Internal Revenue Code) we need not request the views of the Service if the case has been classified SOP.)

Generally, it is undesirable to process a proposed concession as to only part of a case if the case can be resolved as a whole by settlement. Accordingly, a proposed partial concession should not be processed until the Trial Attorney has explored the possibility of settlement of the case as a whole, and the Trial Attorney's memorandum should set forth why an overall settlement cannot be achieved.

Whether we should negotiate over attorney fees with taxpayer's representative when concession is being considered, and how we negotiate fees in this context, is a grey area and requires a careful analysis of the situation. The Tax Division's position on this matter is contained in Tax Div. Directive No. 87-62, and it states in pertinent part:

Whenever possible, cases that are conceded by the Government should be terminated by a stipulation for dismissal with prejudice, each party to bear its own fees and expenses including attorney fees. Similarly, whenever possible in partial concessions, each party should bear its own attorney fees and expenses with respect to the issue(s) conceded. Where the person

with final authority determines that full concession or partial concession will be conditioned upon settlement of or waiver of costs and attorney fees, 7/ opposing counsel should be informed that any concession is conditioned on disposition of the issue of costs and attorney fees. In cases in which full or partial concession is warranted whether or not the issue of costs and attorney fees is resolved, opposing counsel should be informed of the decision to concede before the issue of costs and attorney fees is broached, and, as a matter of ethics, there should be no suggestion that concession is dependent upon resolution of the issue of costs and attorney fees. Where opposing counsel refuses to waive fees and costs, settlement of the fee and cost issue should be sought. If an offer to settle the fee and cost issue is submitted, the recommendation of District Counsel or Chief Counsel must be requested. Where settlement cannot be reached on the fee and cost issue, a judgment will be entered, leaving the award issue open. But, in such cases, the Trial Attorney should promptly request District Counsel or Chief Counsel to provide the Division with an analysis of the facts and law on the fee and cost issues left open, unless such an analysis has previously been received.

G. Soliciting the Internal Revenue Service recommendation

1. Compromises

If the Trial Attorney determines that the offer does not merit serious consideration, he or she should promptly prepare a brief memorandum recommending summary rejection of the offer and should not request the recommendation of District Counsel or Chief Counsel. If the offer does merit consideration, however, then the following should be observed.

7/ Concessions in this category include cases in which, while the United States has a defensible position, the amount of litigating hazards involved do not justify trial costs, or cases or issues which are conceded because the case does not present a good litigating vehicle for a recurring issue. In these situations, concession would ordinarily not be warranted if attorney fees are not waived since the matter would essentially have to be litigated in any event to resolve the attorney fees dispute.

a. Standard cases

In cases classified "standard" by District Counsel or Chief Counsel (see Part II, Chapter L), the Trial Attorney shall request promptly (i.e., within 3 days of receipt of the offer) the recommendation of District Counsel or Chief Counsel as to the acceptability of the offer. As soon as possible, the Trial Attorney should forward a copy of a draft compromise memorandum to District Counsel or Chief Counsel to assist in their evaluation of the proposal.

The Trial Attorney should bear in mind that the fact that the parties are participating in ADR does not obviate a need for the Internal Revenue Service recommendation in standard cases.

b. SOP cases

In cases classified "SOP" (see Part II, Chapter L) by District Counsel or Chief Counsel, the Tax Division may act on an offer to settle the pending case without obtaining the Service's recommendation. A general litigation case may not be classified SOP if the amount in controversy is more than \$200,000. If the District Counsel's initial letter to the Tax Division in a general litigation case fails to designate the case as either SOP or standard, the Tax Division will presume that the case is classified SOP if it involves less than \$200,000; otherwise, the case must be treated as standard. If the offer covers periods or taxpayers not in suit, the recommendation of the Internal Revenue Service must be obtained.

c. Taxpayers and/or periods not in suit

When a proposed settlement of a standard or SOP case includes a taxpayer or period not in the pending litigation, pursuant to Delegation Order 155 (Rev. 4, Aug. 15, 1996), the Internal Revenue Service recommendation letter must be signed by one of the following officials:

(1) Chief Counsel, Associate Chief Counsel, or Deputy Associate Chief Counsel with respect to settlements including persons or periods not in suit, except as otherwise specified.

(2) District Counsel, Regional Counsel or Assistant Chief Counsel with respect to settlements including--

(a) periods not in suit ending prior to the date of the settlement agreement;

- (b) tax consequences for periods not in suit ending after the date of the settlement agreement that necessarily result from the settlement of the periods in suit;
- (c) issues conceded in full by the taxpayer for periods not in suit ending after the date of the settlement agreement;
- (d) persons not in suit for the periods described in (a); and
- (e) persons not in suit for the items described in (b) and (c).

Where a proposed settlement provides for the execution of a closing agreement as part of the settlement, the closing agreement must be reviewed by the appropriate Internal Revenue Service office prior to the Government's acceptance of the offer. Indeed, in almost all cases, as when subsequent years are pending in the Appeals Office of the Service, the Service office involved will prepare the closing agreement. In this situation the Trial Attorney should review the closing agreement, as well.

d. The 45-day rule

In cases where the Chief of the Civil Trial Section or the Court of Federal Claims Section determines that the Internal Revenue Service has not timely responded to a request for recommendation on an offer, the Chief may advise the appropriate Internal Revenue Service office by letter that, unless the Tax Division hears from that office within 45 days, the Tax Division will process the case on the assumption that the Internal Revenue Service has no objection to the proposed settlement. A form of letter to District Counsel or Chief Counsel invoking the 45-day rule is in the Appendix as Exhibit D. Before determining that the Internal Revenue Service has failed to respond in a timely manner, the Service must have received (either in advance of or with the 45-day letter) everything needed to review the proposed settlement, including a copy of the compromise memorandum.

The Internal Revenue Service is considered to have responded to the 45-day letter if, within the 45-day period, the Tax Division receives either (1) a recommendation or (2) a request for additional time and an estimate as to when the recommendation will be received. This 45-day procedure is not applicable to settlements that must be approved by the Associate Attorney General or referred to the Joint Committee on Taxation, or that include a taxpayer or period not in suit.

2. Concessions

If the Trial Attorney is of the view that a case should be conceded in whole or in part, the Trial Attorney should request the recommendation of District Counsel or Chief Counsel as to the proposed concession, forwarding a copy of his or her concession memorandum. The recommendation of District Counsel or Chief Counsel is required in all cases, except SOP cases involving liability under § 6672 of the Internal Revenue Code. If the Tax Division does not receive a recommendation within 30 days from the date of the letter requesting the recommendation in a refund suit classified SOP, the Tax Division may process the case on the assumption that Chief Counsel or District Counsel has no objection to the proposed concession, except where the proposed concession must be approved by the Associate Attorney General or referred to the Joint Committee on Taxation. Internal Revenue Manual (35)(18)45; Ex. E.

H. The offer list

1. The offer list and how it is used

Whenever a settlement offer is received from a taxpayer, it is logged onto the Tax Division's computer. Subsequent action on the offer (e.g., sending it to the Service for its views; receiving the Service's views; action by the Trial Section; action by the Office of Review) is also entered onto the computer. Every two months the Division front office (i.e., the Office of the Assistant Attorney General) calls for a list of all the cases with offers pending, and that list reflects the date the offer was received and what has happened (or not happened) since that time. One column on the list is reserved for remarks, and that space is used to explain why we have not yet acted on an offer.

The Tax Division uses the list to monitor the pace at which we settle cases. "Stale" offers show up, along with our explanations of why we have not yet acted on them. This enables the Division management to ensure that we are processing our offers with reasonable diligence and, if necessary, to prod us when we are not.

2. Why the Tax Division cares about the pace of settlement

The longer it takes the Government to process offers, the less incentive there is to taxpayers to make such offers. Moreover, as a matter of courtesy, offers should be acted on promptly. If an offer is not adequate, it should be rejected

promptly. If it is acceptable, it should be accepted promptly--both as a matter of courtesy, and as a reward to the cooperative taxpayer and its counsel. It is poor thanks to a taxpayer who has made a reasonable offer to have that offer languish, while the Trial Attorney attends to what are regarded as more stringent deadlines in cases with less cooperative opponents.

3. What an attorney can do to "stay off
the list"

Simultaneously obtaining good settlements and "staying off the offer list" is the attorney's goal. Of course, the obvious way to do this is to immediately write one's compromise memorandum, which is sometimes difficult or impossible. Short of doing that, however, there are useful procedures that can save considerable time:

(a) Discourage unsolicited offers. When settlement first comes up, explain to the opponent that the Trial Attorney's favorable recommendation is almost always necessary for a settlement to occur, and that one would prefer that the taxpayer make no offer until after one has negotiated and agreed to make a favorable recommendation.

(b) Discourage premature offers. Taxpayers sometimes make offers early in the case--aware that we know little or nothing about the case--with the bona fide intention that the settlement offer remain pending while we conduct discovery and learn whether the offer is a good one. Such offers are more harm than help, in that they provoke the Section Chief (and the Front Office) to inquire repeatedly about the pendency of offers which are simply premature.

(c) Keep the Service and supervisory staff familiar with the case informed during settlement negotiations. Particularly in a standard case, check with District Counsel or Chief Counsel to get their informal views on what the offer should look like. It will not only improve the quality of the offer but also cut down (a) the amount of time it takes them to consider the offer and (b) the number of times one has to write supplemental memoranda on additional issues.

(d) Utilize taxpayer's submissions in preparing the compromise memorandum. The compromise memorandum is an evaluation of the case that consists essentially of (1) taxpayer's version of the facts, (2) the Government's version of the facts, (3) taxpayer's legal position, and (4) the Government's legal position. If taxpayer proposes, early in the case, a comprehensive stipulation of facts (with citations to the

documents, affidavits, and depositions it relies on), it will probably be very easy to draft a statement of the facts. (Before soliciting such a draft stipulation, consider whether it would be preferable for the Trial Attorney to go first in the stipulation process.) Additionally, the Trial Attorney can ask taxpayer for a statement of taxpayer's position on the specific legal questions to be addressed in the memorandum. (E.g., "Why isn't this a change of accounting method?" "Why isn't this a variance from the refund claim?") If these can be obtained during the negotiation stage, then large chunks of the memorandum will be drafted before the offer is received.

(e) Draft the compromise memorandum during the negotiation process. Most of the material in the memorandum is material that the Trial Attorney will eventually have to write in any event (unless taxpayer gives up)--either as a pretrial brief or as a compromise memorandum. So it is not a question of whether to write it but when to write it. The Trial Attorney might as well do it early: the supervisor who reviews the transmittal letter gets an early look, makes comments, and gets on board; the Service's consideration is assisted and expedited; and the memorandum is ready very shortly after the offer is received.

(f) Send the Service a copy of the draft memorandum. Send it promptly, and give your District Counsel or Chief Counsel counterpart any other information or documents that he or she will need to evaluate the offer. When an offer in a non-SOP case comes in, the Tax Division immediately asks the Service for its views. Thus, remarks on the offer list often state that a stale offer is awaiting the views of the Service. The jaundiced eye, however, may look askance at that explanation. When the Service gets a settlement offer with no explanation from the Trial Attorney as to why the offer is good (or not good), it often takes the District Counsel or Chief Counsel attorney a long time to evaluate the offer. On the other hand, with a draft of the compromise memorandum, the District Counsel or Chief Counsel attorney is often able to render an opinion quickly.

(g) Reject offers quickly--in the appropriate case. On occasion we receive an offer that the Trial Attorney thinks is not good enough, but the Trial Attorney hopes to be able to negotiate a better offer, and so leaves the offer pending during this post-offer negotiation. Sometimes this is surely the right approach. In other instances, however, leaving the prior offer pending may send the wrong signal to the taxpayer (i.e., that maybe the Government will accept the offer if it can't get a better one) and leaves on the offer list a case that really calls for rejection.

I. Settlement and concession memoranda

A recommendation for settlement or concession is made in a memorandum prepared by the Trial Attorney. A form of memorandum is contained in the Appendix as Exhibit F. The top page of the memorandum should contain the date, the name of the case, and the nature of the suit, including the years or periods involved in the litigation. 8/ State the amount involved in the litigation, whether it is an amount claimed by the taxpayer or by the Government. Also state the amount to be paid by the Government, and the amount to be paid to the Government (or in a partial concession of a Government claim, the amount of reduction of such claim). In discussing the amounts at issue in the lawsuit and the amounts to be paid by or to the Government, or refunded, the Trial Attorney should always detail the treatment of interest.

The top page of the memorandum should also contain the date of the offer. Normally this date is the date of the offer letter prepared by the taxpayer or other parties seeking to settle. If the offer has been amended, the dates of any amendments should be set out. Next, the memorandum should list the recommendations of the Internal Revenue Service, usually by using one of the following forms:

1. "Acceptance [concession] by Letter Dated _____,"
2. "Rejection [Defense] by Letter Dated _____,"
3. "Classified SOP by Letter Dated _____."

Remember in preparing this part of the memorandum that the District Counsel, Regional Counsel or Assistant Chief Counsel may not have the authority to sign a recommendation letter on an offer that includes taxpayers or periods not in suit. See discussion at Chapter G of this Part, Section 1.c., pp. 32-33, supra.

Below the Internal Revenue Service recommendation is the Trial Attorney's recommendation. The name, address, and telephone number of the taxpayer's representative also appear in this part of the memorandum. In a refund case which involves the making of a refund, the address stated in the memorandum will be used by the Post Litigation Procedures Unit (PLPU) to ascertain

8/ If the settlement involves years or taxpayers not in suit, that information (and the concessions called for by the offer as to such non-suit years or taxpayers) should also appear on the top page of the memorandum.

the correct address to which to send the refund check. Therefore, it is important to be sure that this information is correct.

The body of the memorandum consists generally of five to seven parts: (1) questions presented; (2) terms of offer; (3) statutes and regulations involved; (4) a jurisdictional statement, setting out those facts which establish that the refund claim and suit are timely in whole or in part; (5) the statement (which normally sets out the facts); (6) the discussion, which would include any relevant comments by the court; and (7) conclusion. A few points are worth making about the body of the memorandum.

When discussing the questions presented, it is more useful to list the substantive questions rather than to use a more general presentation such as "should the offer be accepted given the litigating hazards?" Since the reader already knows that settlement is being considered either on litigating hazards or a collectibility basis, it is much more useful for the reader to learn something about the case. For example: "Are the hairdressers who work for the taxpayer employees or independent contractors?"

The questions presented and terms of offer may be combined, as, for example: whether the taxpayer has substantiated adequately claimed travel and entertainment expenses for 1989-1990. Under the proposed settlement, the taxpayer concedes 1989 (involving a total of some \$100,000 in claimed expenses) and the Government concedes 50% of the \$200,000 involved with respect to 1990.

It is extremely helpful if the "statement" section of the memorandum contains the facts needed to verify the presence of jurisdiction for a refund suit, for example, the filing date of the original return, the existence of any extensions of the statute of limitations for assessments and collections with respect to the subject tax period, the filing date of the refund claim, the date of any Service action with respect to the claim, the filing date of the complaint, and the applicability of any Internal Revenue Code § 6511(b) limitations regarding the proposed settlement overpayment. Moreover, at this juncture, it is a good idea to obtain and review a current transcript of account, to make sure that there have been no developments (e.g., a tentative refund) which affect the amount in controversy, or which should be addressed in considering the settlement. 9/

9/ It may be, for example, that tentative allowances based on carrybacks have been allowed, and the Service has not audited

The "discussion" section of the memorandum should, in a litigating hazard settlement, explain the strength and weakness of the Government's position with respect to all issues involved in the case (or all issues covered in a partial settlement). The memorandum should also address any issues identified in the Internal Revenue Service's recommendation. Sometimes the Trial Attorney may believe that the Internal Revenue Service's analysis on a particular issue is wrong or irrelevant. It is very helpful to the person who must act on the offer if the memorandum explains why.

Despite the efforts to make sure that the terms of settlement are clear at the time the offer is made and it is acknowledged by the Government, there will be occasions when an additional matter needs to be addressed in the acceptance letter or by way of counteroffer. These issues should be identified in the memorandum.

When preparing the memorandum, make it as easy as possible for those who must also add their recommendation or act on the offer to check the accuracy of the statements made in the memorandum or to review the relevant documents. If the memorandum refers to documents, please make sure that they are either attached as exhibits to the memorandum or are tabbed in the files which are sent forward with the memorandum.

The materials which should be forwarded with the settlement memorandum and Settlement Checklist are normally the following:

1. Up-to-date Internal Revenue Service transcripts of the taxpayer's account.
2. Internal Revenue Service administrative records pertaining to the periods and issues in suit.
3. The Internal Revenue Service's settlement recommendation in non-SOP cases.

the years generating the carryback; in this situation, the settlement should be without prejudice to the Government's right to audit and, if necessary, assess for the carryback years in suit. Absent special provision, the filing of a stipulation for dismissal (or, indeed, a judgment) could close the years.

For the requirement of submitting to the Joint Committee on Taxation any settlement involving a year where prior tentative allowances exceed \$1,000,000, regardless of whether there is a proposed refund, or its amount, see Part II, Chapter C, supra.

4. The Department of Justice files or the Trial Attorney's files relating to the ongoing litigation.

5. Pertinent discovery materials.

6. In a collectibility settlement, a completed Statement of Financial Condition and Other Information (DJ-TD 433 (1996)), and income tax returns for the past five years. (Form DJ-TD 433 (1996) (Ex. C) supersedes IRS Form 433. Do not use Forms 433-A or 433-B, which are not satisfactory for our purposes.)

7. A signed collateral agreement in a collectibility settlement.

8. In a case within the Trial Section Chief's settlement authority, an action sheet setting out the action the Trial Attorney recommends. See Ex. G. (In a case going to the Office of Review, the action sheet is prepared by that Office.)

9. In a case within the Trial Section Chief's settlement authority, the appropriate letters advising opposing counsel and the Service of the action on the settlement. See Chapter M, infra.

A well-written and thorough settlement memorandum will considerably expedite the settlement process.

J. Settlement Checklist

Form TAX-108 (Ex. H) is a Settlement Checklist which is to be submitted with the memorandum. Its purpose is two-fold: (1) to set out, on one page, the procedural or generic information (e.g., time limit, date of offer), which makes it easier for the person reviewing the settlement to see at a glance what is involved; and (2) to remind the Trial Attorney of points to consider and/or address in connection with settlement.

With respect to the second point, question V on the Settlement Checklist sheet addresses concerns which are discussed at length in Part V, Collectibility Settlements. Does the offer provide that a lump sum or initial payment be made within a set time? Are fixed deferred payments secured? Do they bear interest? Are there current financial statements on Form DJ-TD 433 (1996)? Has that form been verified by the Internal Revenue Service? Have tax returns for the last five years been analyzed? Is there a collateral agreement? Does taxpayer waive any deductions?

Similarly, question VI of the checklist is intended, inter alia, to remind the Trial Attorney of questions and problems which are addressed in Part IV, Offset, Double Allowances--Mitigation of Limitations, and Equitable Recoupment.

K. Special considerations on submission
of case to Office of Review

Prior to submitting a non-SOP case to the Office of Review, it is the responsibility of the Civil Trial Section, the Court of Federal Claims Section, or the Appellate Section to obtain the recommendation of the Chief Counsel or District Counsel, except in the situation where the Trial Attorney has discussed the proposed settlement with the Internal Revenue Service attorney assigned the case and has been assured that the Service's favorable recommendation will be forwarded within a few days. In that situation, it remains the Trial Attorney's responsibility to obtain the recommendation of the Service. The Appellate Section also must obtain the recommendation of the Civil Trial Section in which the case originated. Additionally, it is the responsibility of the Civil Trial Section, the Court of Federal Claims Section, or the Appellate Section to obtain and check any computations required under the compromise or concession.

If the Office of Review determines that further factual development of a case is necessary, or additional issues should be addressed, the Civil Trial Section, the Court of Federal Claims Section, or the Appellate Section is responsible for whatever additional work is necessary.

The Office of Review will keep the Trial Attorney advised of any time exigencies which prevent reasonably prompt addressing of the settlement by Review. Conversely, the Trial Attorney should consult with the Office of Review concerning representations made to the court concerning the time necessary to act on the settlement, and furnish the Office of Review with a draft of any such representations before they are submitted to the court.

L. Responsibility of the Assistant United States Attorneys in Tax Division cases

The Assistant United States Attorney assigned to handle a case on behalf of the Tax Division has the responsibility for preparing a memorandum recommending acceptance or rejection of an offer to compromise such case. If the Assistant United States Attorney determines concession of the case or of an issue is warranted, the Assistant United States Attorney must prepare a memorandum recommending concession. The memorandum should be addressed to the Assistant Attorney General and must contain a statement of the facts, an analysis of the law, a statement of the terms of the proposed settlement, and a discussion of the reasons underlying the recommendation. The memorandum is forwarded to the chief of the section concerned, together with the administrative files and a copy of the offer. If necessary, the Assistant United States Attorney obtains the recommendation of District Counsel or Chief Counsel, a computation, and/or a current transcript of account.

M. Acceptance letters and other correspondence

An acceptance letter must be written with the greatest possible care, inasmuch as the offer and acceptance constitute a contract between the parties. Form letters are exactly that --forms. They frequently must be modified to suit the particular case. A settlement memorandum may describe a settlement greatly in the Government's best interests--but, unless care is taken in the acceptance letter, those benefits may not be achieved.

Forms of letters advising of rejection of an offer or acceptance of an offer are in the Appendix as Exhibit I (Rejection Letters), Exhibit J (Refund Due under the Compromise), and Exhibit K (Payment Due the United States under the Compromise). Forms of Stipulations for Dismissal generally used in compromises (and concessions) are in the Appendix as Exhibit L. Forms of Stipulations for Entry of Judgment where payments are due the Government are in the Appendix as Exhibit M. 10/

10/ Acceptance letters in collectibility settlements are particularly difficult to draft, and must be crafted with specific reference to all terms of settlement. Such terms are discussed in depth in Part V, infra, at pp. 58-66. For example, in a collectibility settlement, typically judgment is entered for the full amount of the Government's claim, and the judgment is marked satisfied when all payments called for under the settlement have been paid.

Forms of concession letters in refund suits are in the Appendix as Exhibit N.

It is the responsibility of the Civil Trial Section, the Court of Federal Claims Section, or the Appellate Section to advise by letter taxpayer's counsel and District Counsel or Chief Counsel of the action taken on the offer or of the approval of a concession in cases where final action is taken by that Section. In all other cases, it is the responsibility of the Office of Review.

In cases that can be acted on within the trial section or the Appellate Section, a Trial Attorney is required to prepare the letters and send them forward at the time the case is submitted to the Section Chief for action. This practice will enable the Section Chief to review the offer efficiently with only one review of the case file and memorandum.

N. Issuance of refunds

1. Preparation of Forms M-4457 authorizing issuance of refund

The Tax Division prepares and forwards directly to the Service Center (District Director in 100% penalty cases) payment authorization memoranda (Forms M-4457) directing the issuance of a refund pursuant to a compromise or concession. A copy of the payment authorization memorandum is sent to District Counsel or Chief Counsel and another copy is sent to the Post Litigation Procedures Unit.

This procedure is applicable with respect to cases where the amount of the overpayment is known prior to the Department's acceptance of the offer or approval of the concession. It is also applicable if the amount of the overpayment will be computed by the Tax Division's recomputation specialist after the Department's acceptance of the offer or approval of the concession.

The Form M-4457 is prepared by the Trial Attorney or Office of Review at the same time the letters are prepared advising counsel for taxpayer and District Counsel or Chief Counsel of the acceptance of the offer or approval of the concession. Before preparing the Form M-4457, the Trial Attorney or Office of Review should obtain a current transcript of account.

Instructions for completion of the form and sample completed forms are in the Appendix as Exhibit O. Blank forms are available in each section front office. Addresses of Service Centers

to be used in memoranda authorizing payment are also included in Exhibit O.

The authorization to issue a refund must be very clear. For example, if you are settling a case involving three years on the basis of overpayments of 50% of the tax and assessed interest paid involved, specify the amounts of the refund of tax and assessed interest paid for each year.

2. Verifying correctness of the refund check, whether
the refund is pursuant to settlement or judgment

It is the responsibility of the Tax Division to ensure that refund checks issued pursuant to compromises, concessions or judgments are accurate, both as to the principal amount of the refund and as to statutory interest. This review is necessary because, whereas a taxpayer will generally complain if the refund check is inadequate, very few, if any, inquiries are received because a taxpayer believes that the amount allowed is excessive.

Refund checks, together with the notice of adjustment and statutory interest computation, are sent by the Internal Revenue Service to our Post Litigation Support Unit. This Unit will send the Trial Attorney (or Office of Review in cases handled by that Office) a copy of the notice of adjustment and statutory interest computation. Before sending these documents to the Trial Attorney, the Post Litigation Support Unit will ascertain whether the Trial Attorney is scheduled to be in the office within the next week. If the Trial Attorney is not scheduled to be in the office within the next week, the Post Litigation Support Unit will consult with the Section Chief or Assistant Section Chief of the Trial Section.

The Trial Attorney (or Office of Review) should promptly review the notice of adjustment to make sure that it complies with the terms of settlement and the Form M-4457. For example, there may be instances where overpayments for some years trigger deficiencies for other years, for which no deficiencies have been assessed, although, had the case gone to judgment and the same result obtained, the period of limitations would have been reopened by §§ 1311 et seq. of the Code. In such a situation, the Form M-4457 will typically direct that the deficiencies be offset against the overpayments, and only the net amount refunded. Unless great care has been taken, however, there is a good chance that the Service Center will simply allow the overpayment, ignoring the deficiencies because they have not been assessed. Accordingly, if you have this situation, you may want to consult with the Service Center about this at the time the M-

4457 is prepared, and be sure to check the notice of adjustment as soon as it is received.

Similarly, the Trial Attorney (or Office of Review) should review the statutory interest computation to make sure that it is correct. 11/ The Service can make very serious errors in the computation of statutory interest. There have been cases where grossly excessive amounts of interest were allowed, either with respect to settlements or judgments, 12/ but the recovery of the erroneous refund was barred by limitation. Guidelines as to calculation of interest are discussed in "A Bird's Eye View of Some General Principles re Interest," which appears in the Appendix as Exhibit Q.

Preparation of the M-4457 and determination of the amount of judgment require analysis of the transcript of account (which shows the date of all payments of tax). At that time the Trial Attorney (or the Office of Review) will have in mind such questions as whether interest is restricted because of carrybacks. This is the information necessary to verify the calculation of interest, which involves knowing from what date to what date interest is calculated on what amount. Accordingly, to facilitate the verification of the amounts of refund checks, it is suggested that, at the time the Form M-4457 or judgment is prepared, an interim computation also be prepared of the

11/ A determination has been made that verification by the Trial Attorney of the statutory interest computation will not be required in the case of refunds of responsible person penalties (§ 6672) because the amounts are relatively small and the interest computations are straightforward. However, it is important to calculate and verify the amount owing to the Government with respect to judgments or settlements calling for payments to the Government of § 6672 penalty plus interest; a number of payments can complicate the interest computations, and in such cases it is not unusual for the interest to be greater than the penalty.

12/ The largest excessive allowances of statutory interest have occurred with respect to judgments. Where there is a judgment calling for a refund, the Tax Division does not prepare a Form M-4457, but the Internal Revenue Service prepares a Form M-4456, based on the judgment. A sample Form M-4456 is attached as Exhibit P. Note that where refunds for several years are involved, the judgment (like the Forms M-4456 and M-4457) should set out separately the amount of tax and assessed interest paid to be refunded for each year.

statutory interest payable to date on the amount of the refund.
13/ If an interim computation has been prepared, when the statutory interest computation is received from the Service Center all that needs to be done is to update the interest computation (generally to the date of the refund check), particularly if there has been a significant time lapse or a substantial amount is involved, and to determine whether there is a significant discrepancy.

In all cases, if the Trial Attorney (or a paralegal under the Trial Attorney's direction) is unable to verify the correctness of the refund check, whether as to principal or interest, or to prepare the interim interest computation, or resolve any discrepancies in the computation of the statutory interest, the Trial Attorney should seek the assistance of the Tax Division's recomputation specialist.

The Post Litigation Support Unit will not forward the refund check (and notice of adjustment and statutory interest computation) to taxpayer's counsel until it has been advised by the Trial Attorney or Office of Review that the check is in the correct amount.

13/ This computation can be prepared either by the attorney or by a paralegal, pursuant to the information concerning dates and amounts provided by the attorney. This interim computation should not be sent to the Service Center.